



**Management's Discussion and Analysis  
and Basic Financial Statements**  
December 31, 2005 and 2004

**Kane County Human Resource  
Special Service District  
dba Kane County Hospital**

**KANE COUNTY HUMAN RESOURCE SPECIAL  
SERVICE DISTRICT  
DBA KANE COUNTY HOSPITAL**

Table of Contents

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	<u>Page</u>
<b>INDEPENDENT AUDITOR'S REPORT</b>	1
<b>MANAGEMENT'S DISCUSSION AND ANALYSIS</b>	3
<b>FINANCIAL STATEMENTS</b>	
Balance Sheets	6
Revenues, Expenses, and Changes in Net Assets	7
Cash Flows	8
Notes to Financial Statements	10
<b>SUPPLEMENTARY INFORMATION</b>	
Independent Auditor's Report on Supplementary Information	23
Kane County Hospital Auxiliary Fund	24
<b>OTHER REPORTS</b>	
Independent Auditor's Report on State of Utah Legal Compliance	25
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> and Communications with Audit Committee	27



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## INDEPENDENT AUDITOR'S REPORT

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The Board of Trustees  
Kane County Human Resource  
Special Service District  
dba Kane County Hospital  
Kanab, Utah

We have audited the accompanying balance sheets of **Kane County Human Resource Special Service District, dba Kane County Hospital**, a Utah Special Service District, as of December 31, 2005 and 2004, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the management of **Kane County Human Resource Special Service District, dba Kane County Hospital**. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of **Kane County Human Resource Special Service District, dba Kane County Hospital's** internal control over financial reporting. Accordingly we do not express such an opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Notes 1 and 4, **Kane County Human Resource Special Service District, dba Kane County Hospital** is a component unit of Kane County. These financial statements present only the funds of **Kane County Human Resource Special Service District, dba Kane County Hospital** and do not purport to, and do not present fairly the financial position of Kane County, Utah, and the changes in its financial position or, as applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph, present fairly, in all material respects, the financial position of **Kane County Human Resource Special Service District, dba Kane County Hospital** as of December 31, 2005 and 2004, and the results of its operations, changes in net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2006, on our consideration of **Kane County Human Resource Special Service District, dba Kane County Hospital's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. We have also issued our dated March 30, 2006 of **Kane County Human Resource Special Service District, dba Kane County Hospital's** compliance with Utah laws and regulations.

The management's discussion and analysis on pages 3 through 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. As a result of such limited procedures, we believe the comparative information for comparison of 2004 and 2003 has been omitted and the discussion fails to address changes in capital assets and long-term debt for 2005 vs. 2004 vs. 2003. However, we did not audit the information and express no opinion on management's discussion and analysis.

A handwritten signature in black ink, appearing to read "Eric Bailey" followed by a stylized monogram or initials.

Minneapolis, Minnesota  
March 30, 2006

**KANE COUNTY HUMAN RESOURCE  
SPECIAL SERVICE DISTRICT  
DBA KANE COUNTY HOSPITAL  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
DECEMBER 31, 2005 AND 2004**

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**Basic Financial Statements**

The basic financial statements include the Balance Sheet and Statements of Revenues, Expenses, and Changes in Net Assets. The Balance Sheet is a 'snapshot' of the assets and liabilities of the Special Service District (Hospital) at year-end. It is useful to compare the changes from year to year of the assets available to meet the operational needs and accomplish the mission of the Hospital. The Balance Sheet also shows the liabilities or debt of the Hospital. The liabilities are obligations of the Hospital and offset the value of the assets in the calculation of Net Assets.

The Statements of Revenues, Expenses, and Changes in Net Assets shows both operating and nonoperating revenues and expenses. It also explains the change in Net Assets on the Balance Sheet.

**Assets**

Total Assets increased 6.3 percent. Capital Assets; land, buildings, and equipment; decreased 8.3 percent. There were no significant disposals of assets. The purchase of new equipment of about \$140,700 was offset by normal depreciation. Assets Limited as to Use decreased 12.1 percent. The majority of this change is in an account that holds part of the bond proceeds for equipment purchases and other financial needs of the Special Service District. This account naturally decreases as the funds are used.

The decreases above are offset by the increase in current assets of 43.8 percent. The increase in cash is from timing. The statement is just prior to paying payroll and some substantial trade accounts payable. The increase in patient receivables is the major component of the increase. Some of the increase is due to increases in patient service revenue. Most of the increase reflects significant delays in billing. During the year a significant change in the patient accounting computer system interfered with billing. At the end of the year, the process of converting to a HIPAA compliant electronic billing product seriously interrupted billing our major payers. In the beginning of 2005 the process was completed and most of the 'bugs' corrected. During the first four months of 2006 considerable improvement has been made and is expected to continue bringing patient receivable to acceptable levels.

**Liabilities**

Total Liabilities decreased 25.5 percent. Total long-term debt, including current maturities, decreased 23.5 percent as scheduled payments were made.

## MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

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### Net Assets

The Net Assets are divided in three parts: 1. Invested in Capital Assets, Net of Related Debt:, land, buildings, and equipment. Capital Assets and are essential to providing services at the Special Service District. They are not liquid and not generally available to meet current obligations of debt; 2. Restricted to Debt Service: These are funds held to make bond payments. A semi-annual payment was just paid prior to year-end. These funds are replenished with Sales Tax revenue and structured so half of the sales tax received is adequate for the payments; 3. Unrestricted Net Assets: This represents the assets available for use in meeting current obligations and operational needs. The over all change in Net Assets is explained in The Statements of Revenues, Expenses, and Changes in Net Assets.

### Operating Revenue

Net Patient Revenue increased 27.4%. The change is reflected in the following statistics:

- Patient days increased from 707 to 782.
- Long-term care days decreased slightly from 8,988 to 8,870.
- Emergency room visits decreased slightly from 2,323 to 2,296.
- Surgical cases increased from 115 to 139.
- Total radiological imaging visits increased from 4,440 to 5,131.
- Included in the above are increases in CT Scans from 735 to 1,259 and in Ultrasound from 413 to 505.
- Laboratory workload increased 6.7%.
- Clinic Visits increased 5.8%.

Sales tax revenue increased 13.3% compared to an increase of 3.7% last year.

### Operating Expenses

Total operating expenses increased 14.6%. This is good when compared with the 24.7% increases in operating revenue. Total wages, benefits, and physician fees increased 11.4%. These 3 items make up 63.5% of total expenses. Food, drugs, and supplies increased 18.8% and make up 14.0% of total expenses. Other professional fees increased 52.6%, about \$115,000. Most of this increase is because it was necessary to hire outside nurses to cover a number of shifts in the skilled nursing unit. We believe we have adequate nursing staff now to avoid that extra expense.

### Nonoperating Revenues and Expenses

Investment income is interest received primarily on the account that holds the remaining proceeds from the bonds. As those funds are used the principal and there for interest decreases. Similarly, the interest expense decreases as the bond principal is paid off. The 2005 level of general contributions is about what the Special Service District has averaged in a year. The bulk of the contributions comes through the Auxiliary and state Emergency Medical Services. Mineral lease funds received have been quite stable over the last few years.

## MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

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### Overall

The financial statements reflect general improvement in the financial viability of the Special Service District. Patient volumes have increased compared with both the prior year and the 2005 budget. The expenses have also increased at a lower rate. There are significant opportunities that may improve the reimbursement to the Special Service District. The clinic was converted to a Rural Health Center on January 1, 2005. This will improve Medicare and Medicaid reimbursement for physician services. We are evaluating whether the Special Service District should convert to Medicare's Critical Access Program to bolster Medicare reimbursement of the Special Service District's inpatient and outpatient services.

The area the Special Service District serves, Kane County and northern Arizona, seems to be continuing to grow. The growth offers the opportunity for more efficient utilization of the Hospital resources and a chance to expand to better serve the area outside of Kanab.

### Contacting the Special Service District's Management

This financial report is designated to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Special Service District's finances and to show the Special Service District's accountability for the money it receives. If you have questions about this report or need additional information, contact either the Administrator's office or the Finance Director's office at Kane County Hospital, 355 North Main, Kanab, UT 84741.

**KANE COUNTY HUMAN RESOURCE  
SPECIAL SERVICE DISTRICT  
DBA KANE COUNTY HOSPITAL  
BALANCE SHEETS  
DECEMBER 31, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,116,849	\$ 404,157
Receivables		
Patient, net of estimated uncollectibles of approximately \$543,000 in 2005 and \$467,000 in 2004 and contractual adjustments of approximately \$447,000 in 2005 and \$585,000 in 2004	1,660,476	1,525,000
Notes	180,000	180,000
Other	81,466	27,824
Estimated third-party payor settlements	25,000	-
Sales tax receivable	232,096	181,349
Mineral lease receivable	68,760	67,068
Supplies	140,967	90,156
Prepaid expenses	108,382	38,051
Total current assets	<u>3,613,996</u>	<u>2,513,605</u>
<b>ASSETS LIMITED AS TO USE</b>	<u>673,391</u>	<u>766,358</u>
<b>CAPITAL ASSETS</b>		
Land, non depreciable	141,814	141,814
Depreciable capital assets	<u>4,607,365</u>	<u>5,036,506</u>
Total capital assets	<u>4,749,179</u>	<u>5,178,320</u>
<b>OTHER ASSETS</b>		
Notes receivable, net of estimated uncollectibles of approximately \$175,000 in 2005 and \$185,000 in 2004	140,550	161,436
Deferred financing costs, net of accumulated amortization of \$22,645 in 2005 and \$14,652 in 2004	<u>24,643</u>	<u>32,636</u>
Total other assets	<u>165,193</u>	<u>194,072</u>
Total assets	<u><u>\$ 9,201,759</u></u>	<u><u>\$ 8,652,355</u></u>

See Notes to Financial Statements



	2005	2004
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Current maturities of long-term debt	\$ 422,078	\$ 406,153
Accounts payable		
Trade	256,700	393,430
Estimated third-party payor settlements	-	125,000
Accrued salaries, wages, and benefits	302,966	277,506
Total current liabilities	981,744	1,202,089
 <b>LONG-TERM DEBT, less current maturities</b>		
	897,176	1,319,254
Total liabilities	1,878,920	2,521,343
 <b>NET ASSETS</b>		
Invested in capital assets net of related debt	3,454,568	3,485,549
Restricted for debt service	673,391	766,358
Unrestricted	3,194,880	1,879,105
Total net assets	7,322,839	6,131,012
 <b>Total liabilities and net assets</b>		
	<u>\$ 9,201,759</u>	<u>\$ 8,652,355</u>

**KANE COUNTY HUMAN RESOURCE  
SPECIAL SERVICE DISTRICT  
DBA KANE COUNTY HOSPITAL  
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
YEARS ENDED DECEMBER 31, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<b>OPERATING REVENUES</b>		
Net patient service revenue	\$ 7,701,115	\$ 6,044,988
Sales tax revenue	1,124,552	992,188
Other revenue	77,174	100,073
Total operating revenues	<u>8,902,841</u>	<u>7,137,249</u>
<b>OPERATING EXPENSES</b>		
Nursing services	962,868	961,171
Other professional services	3,729,959	2,969,526
General services	743,804	666,312
Administrative services	1,906,252	1,739,627
Depreciation and amortization	577,847	576,294
Total operating expenses	<u>7,920,730</u>	<u>6,912,930</u>
<b>OPERATING INCOME</b>	<u>982,111</u>	<u>224,319</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment income	25,251	12,463
Interest expense	(74,898)	(83,012)
General contributions	120,148	109,992
Mineral lease revenue	139,215	135,018
Total nonoperating revenues	<u>209,716</u>	<u>174,461</u>
<b>INCREASE IN NET ASSETS</b>	<u>1,191,827</u>	<u>398,780</u>
<b>NET ASSETS, BEGINNING OF YEAR</b>	<u>6,131,012</u>	<u>5,732,232</u>
<b>NET ASSETS, END OF YEAR</b>	<u>\$ 7,322,839</u>	<u>\$ 6,131,012</u>

**KANE COUNTY HUMAN RESOURCE  
SPECIAL SERVICE DISTRICT  
DBA KANE COUNTY HOSPITAL  
STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<b>OPERATING ACTIVITIES</b>		
Receipts from and on behalf of patients	\$ 7,436,525	\$ 5,342,143
Payments to suppliers and contractors	(3,446,049)	(2,089,002)
Payments to employees	(4,129,246)	(3,928,648)
Receipts from sales tax	1,073,805	981,839
Other receipts and payments	23,532	102,872
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<u>958,567</u>	<u>409,204</u>
<b>NONCAPITAL FINANCING ACTIVITIES</b>		
Mineral lease receipts	137,524	134,190
General contributions	120,148	109,992
<b>NET CASH FROM NONCAPITAL FINANCING ACTIVITIES</b>	<u>257,672</u>	<u>244,182</u>
<b>CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Purchase of capital assets	(140,714)	(209,283)
Repayment of interest on long-term debt	(74,898)	(83,012)
Repayment of long-term debt	(406,153)	(390,608)
<b>NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<u>(621,765)</u>	<u>(682,903)</u>
<b>INVESTING ACTIVITIES</b>		
Interest receipts	25,251	12,463
<b>NET CASH FROM INVESTING ACTIVITIES</b>	<u>25,251</u>	<u>12,463</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<u>619,725</u>	<u>(17,054)</u>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<u>1,170,515</u>	<u>1,187,569</u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u>\$ 1,790,240</u>	<u>\$ 1,170,515</u>
<b>RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE BALANCE SHEETS</b>		
Cash and cash equivalents in current assets	\$ 1,116,849	\$ 404,157
Cash and cash equivalents in assets limited as to use	673,391	766,358
<b>Total cash and cash equivalents</b>	<u>\$ 1,790,240</u>	<u>\$ 1,170,515</u>

(continued on next page)

# STATEMENTS OF CASH FLOWS - CONTINUED

	2005	2004
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	\$ 982,111	\$ 224,319
Adjustments to reconcile operating income to net cash from operating activities		
Depreciation and amortization	577,847	576,294
Provision for bad debts	541,123	448,061
Changes in assets and liabilities		
Receivables	(755,241)	(1,098,699)
Notes receivable	20,886	(27,408)
Sales tax receivable	(50,747)	(10,349)
Supplies	(50,811)	(5,120)
Prepaid expenses	(70,331)	29,510
Accounts payable	(261,730)	235,246
Accrued salaries, wages, and benefits	25,460	37,350
NET CASH FROM OPERATING ACTIVITIES	<u>\$ 958,567</u>	<u>\$ 409,204</u>

**KANE COUNTY HUMAN RESOURCE  
SPECIAL SERVICE DISTRICT  
DBA KANE COUNTY HOSPITAL  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005 AND 2004**

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**NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

*Organization*

Kane County Human Resource Special Service District, dba Kane County Hospital, a Utah Special Service District, (Special Service District), is a special service district established under provisions of Utah Special Service District Act, Chapter 23, Title II, Utah Code Annotated, 1953, as amended, and Article XIV, Section 8 of the Constitution of Utah. The Special Service District is a Hospital licensed for 38 beds. The Special Service District may not issue debt without the approval of Kane County and, for this reason, is considered a component unit of Kane County (Note 4). Being a political subdivision of the State of Utah, the Special Service District is exempt from income taxes. The boundaries of the Special Service District are all real property within the boundaries of Kane County, Utah less and excluding the incorporated areas within the townships of Alton and Big Water.

The Special Service District is governed by a seven member Board of Trustees elected for four-year terms. The Board of Trustees has charge of the administration, maintenance and control of the Special Service District, which consists of a hospital, ambulatory care facility, physician clinic, and an ambulance service.

Also included are the accounts of the Kane County Hospital Auxiliary Fund, whose purpose is to provide financial support to the Special Service District.

*Enterprise Fund Accounting*

The Special Service District uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Special Service District has adopted the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

*Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Cash and Cash Equivalents*

Cash and cash equivalents include highly liquid debt securities with an original maturity of three months or less, including assets limited as to use and the Utah Public Treasurers Investment Fund (UPTIF).

## NOTES TO FINANCIAL STATEMENTS

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### *Notes Receivable*

Notes receivable are private pay patient receivables that are separately identified to reflect periodic payments through payment plans approved by the Special Service District. The carry amount of notes receivable is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients. Management considers historical write off and recovery information in determining the estimated bad debt provision.

### *Patient Receivables*

Patient receivables are uncollateralized customer and third-party payor obligations. Unpaid patient receivables, excluding amounts due from third-party payors, with invoice dates over thirty days old have interest assessed at one percent per month. Due to the uncertainty of collecting private pay accounts, these interest charges are recognized as income when received.

Payments of patient receivables are allocated to the specific claims identified on the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision.

### *Supplies*

Supplies are stated at lower of cost (first-in, first-out) or market.

### *Assets Limited as to Use*

Assets limited as to use include restricted assets held by trustees under bond indenture agreements.

### *Capital Assets*

Capital assets acquisitions in excess of \$500 are capitalized and recorded at cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using these assets lives:

Buildings	8-25 years
Fixed equipment	5-15 years
Movable equipment	2-25 years

## NOTES TO FINANCIAL STATEMENTS

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### *Deferred Financing Costs*

Deferred financing costs are amortized over the period the related obligation is outstanding using the straight-line method.

### *Grants and Contributions*

From time to time, the Special Service District receives grants from the State of Utah as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized as revenue when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisition are reported after nonoperating revenues and expenses. Grants receivable are reported in the balance sheet at net realizable value.

### *Restricted Resources*

When the Special Service District has both restricted and unrestricted resources available to finance a particular program, it is the Special Service District's policy to use restricted resources before unrestricted resources.

### *Net Assets*

Net assets are presented in the following three components:

*Net Assets Invested in Capital Assets Net of Related Debt* - Invested in capital assets net of related debt consist of capital assets, net of accumulated depreciation, unamortized deferred financing costs, and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

*Restricted Expendable Net Assets* - Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditor, grantors, or contributors external to the Special Service District, including amounts deposited as required by revenue bond indenture agreements as discussed in Notes 7 and 9.

*Unrestricted Net Assets* - Unrestricted net assets are remaining net assets that do not meet the definition of "Invested in Capital Assets Net of Related Debt or Restricted".

## NOTES TO FINANCIAL STATEMENTS

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### *Net Patient Service Revenue*

The Special Service District has agreements with third-party payors that provide for payments to the Special Service District at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

### *Operating Revenues and Expenses*

The Special Service District's statements of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Special Service District's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

### *Charity Care*

To fulfill its mission of community service, the Special Service District provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Special Service District does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient service revenue.

### *Advertising Costs*

The Special Service District expenses advertising costs as they are incurred.

### *Compensated Absences*

The Special Service District's employees earn paid-time off at varying rates depending on years of service. Paid time off does accumulate up to a specified maximum. Employees also earn sick leave benefits. Employees may accumulate sick leave up to a specified maximum. Employees are not paid for accumulated sick leave when they retire or terminate employment.

### *Investments in Debt and Equity Investments*

Investments in debt and equity securities are reported at fair value except for short-term highly liquid investments that have a remaining maturity at the time they are purchased of one year or less. These investments are carried at amortized cost. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenues (expenses) when earned or incurred.



## NOTES TO FINANCIAL STATEMENTS

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### *Risk Management*

The Special Service District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

### **NOTE 2 - CHARITY CARE**

The Special Service District maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy and equivalent service statistics. The amounts of charges forgone, based on established rates, were approximately \$95,000 and \$77,000 for the years ended December 31, 2005 and 2004.

### **NOTE 3 - NET PATIENT SERVICE REVENUE**

The Special Service District has agreements with third-party payors that provide for payments to the Special Service District at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per visit. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. The clinic attached to the Special Service District is designated as Certified Provider Based Clinic by the Medicare program. As a result, nonprofessional medical services rendered to Medicare program beneficiaries are reimbursed based on outpatient prospectively determined rates per visit. Professional medical services rendered to Medicare program beneficiaries are reimbursed based on Medicare fee schedules. The Special Service District is reimbursed for cost reimbursement items at a tentative rate with final settlement determined after submission of annual cost reports by the Special Service District and audits thereof by the Medicare fiscal intermediary. The Special Service District's Medicare cost reports have been audited by the Medicare fiscal intermediary through the year ended December 31, 2004.

The Special Service District's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Special Service District.

Medicaid - Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid at a percentage of charges. Inpatient nonacute services (swing beds) related to Medicaid beneficiaries are paid based on prospective per diem rates established by the Medicaid program.

## NOTES TO FINANCIAL STATEMENTS

The Special Service District has also entered into payment agreements with certain commercial insurance carriers and other organizations. The basis for payment to the Special Service District under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

A summary of patient service revenue and revenue adjustments and provision for bad debts for the years ended December 31, 2005 and 2004 is as follows:

	2005	2004
Total patient service revenue	\$ 9,945,803	\$ 8,286,186
Revenue adjustments and provision for bad debts		
Medicare	(936,904)	(1,282,618)
Medicaid	(391,719)	(349,449)
Other	(374,942)	(161,070)
Total revenue adjustments	(1,703,565)	(1,793,137)
Provision for bad debts	(541,123)	(448,061)
Total revenue adjustments and provision for bad debts	(2,244,688)	(2,241,198)
Net patient service revenue	\$ 7,701,115	\$ 6,044,988

### NOTE 4 - AFFILIATED ORGANIZATIONS

The Special Service District is a component unit of Kane County (County). Effective September 1, 1989, the Special Service District entered into an agreement with the County to assume management, operations, and maintenance of the Special Service District on behalf of the County for the purpose of providing and promoting the delivery of quality health care services for the community served by the Special Service District.

A portion of mineral lease revenue (Note 5) and sales tax revenue (Note 6) were received by the Special Service District during 2005 and 2004 fiscal years through the County.

## NOTES TO FINANCIAL STATEMENTS

### NOTE 5 - MINERAL LEASE REVENUE

The Special Service District is eligible to receive mineral lease monies from the State of Utah. The mineral lease receivable as noted on the balance sheet totaled \$68,760 and \$67,068 as of December 31, 2005 and 2004, respectively, represents monies the Special Service District anticipates receiving for the first half of the State of Utah's fiscal year (July 1 through June 30) which have not been distributed to the Special Service District as of December 31. The mineral lease monies are unrestricted funds. Total mineral lease revenue included in the 2005 and 2004 fiscal years statements of revenues, expenses, and changes in net assets totaled \$139,215 and \$135,018, respectively, which consisted of monies received and receivable from the County and Utah's Department of Transportation.

### NOTE 6 - SALES TAX REVENUE

During the 1993 general legislative session, the State of Utah legislature passed a law allowing any Utah county legislative body to put to a vote of that county's residents whether the county could impose a local sales and use tax of one percent to fund rural community hospitals in that county. During 1993, the residents living within the boundaries comprising the Special Service District voted upon and passed a resolution to impose one percent sales and use tax extending through the period ending June 30, 2003. On November 5, 2002, the residents living within the boundaries comprising the Special Service District voted upon and passed a resolution to extend the one percent sales and use tax through the period ending July 1, 2013.

The sales tax receivable as noted on the balance sheet totaled \$232,096 and \$181,349 as of December 31, 2005 and 2004, respectively, represents monies collected by the State of Utah prior to December 31, 2005 and 2004, which had not been distributed to the Special Service District. The sales tax monies are unrestricted funds. The sales tax revenue included in the 2005 and 2004 fiscal years statements of revenues, expenses, and changes in net assets totaled \$1,124,552 and \$992,188, respectively, which consisted of monies received and receivable from the State of Utah and is included in operating revenues.

During the years ended December 31, 2005 and 2004 the Special Service District receipts and uses of the sales tax revenue are summarized below:

	<u>2005</u>	<u>2004</u>
Receipts from sales tax	\$ 1,124,552	\$ 992,188
Payments for principal and interest payments on long-term debt	(481,051)	(473,620)
For operating purposes of the Special Service District	<u>(643,501)</u>	<u>(518,568)</u>
Balance of sales tax revenue as of December 31, 2005 and 2004	<u>\$ -</u>	<u>\$ -</u>

## NOTES TO FINANCIAL STATEMENTS

### NOTE 7 - INVESTMENTS AND INVESTMENT INCOME

The Special Service District's cash and assets limited as to use are reported at fair value as discussed in Note 1. Deposits of cash and assets limited as to use as of December 31, 2005 and 2004 are summarized below:

#### *Deposits - Custodial Credit Risk*

Custodial credit risk is the risk that in the event of a bank failure, the Special Service District's deposits may not be returned to it. The Special Service District does not have a separate deposit policy for custodial credit risk. The Special Service District had bank balances at December 31, 2005 and 2004 as follows:

	2005	2004
Insured (FDIC)	\$ 154,745	\$ 178,746
Uninsured	256,368	303,260
Insured under bond trustee	313,581	762,354
Deposits with Utah Public Treasurer's Investment Fund	1,153,803	45,298
Total Deposits	<u>\$ 1,878,497</u>	<u>\$ 1,289,658</u>
Carrying value on the Balance Sheets	<u>\$ 1,789,590</u>	<u>\$ 1,169,865</u>

The Special Service District follows the requirements of the Utah Money Management Act (Utah Code Annotated 1953, Section 51, Chapter 7) in handling its depository and temporary investment transactions. This law requires the depositing of Government funds in a "qualified depository." The Act defines a "qualified depository" as any financial institution whose deposits are insured by an agency of the federal government and which has been certified by the Commissioner of Financial Institutions as meeting the requirements of the Act and adhering to the rules of the Utah Money Management Council.

#### *Assets Limited as to Use*

The composition of assets limited as to use at December 31, 2005 and 2004, is shown in the following table. Investments are in cash and cash equivalents and are stated at fair value.

	2005	2004
Under bond indenture agreement		
Cash and cash equivalents	<u>\$ 673,391</u>	<u>\$ 766,358</u>

## NOTES TO FINANCIAL STATEMENTS

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### *Investments*

Deposits with the Utah Public Treasurer's fund of \$1,153,803 and \$45,298 are held in the following amounts in 2006:

Corporate debt	58.18%
Commerical paper	3.51%
Money market and certificates of deposit	6.33%
U.S. Treasuries and U.S. government agency debt	31.98%
	<u>100%</u>

### *Credit Risk*

The Utah Money Management Act also defines the types of securities allowed as appropriate temporary investments for Government funds and the conditions for making investment transactions. Investment transactions are to be conducted through qualified depositories or primary reporting dealers.

### *Interest Rate Risk*

The Special Service District investment policy currently does contain a provision that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. At December 31, 2005 the UPTIF has an average adjusted maturity of 59 days. Approximately 34% of the securities mature or reprice within 30 days, with 94% of the securities maturing or repricing within 90 days.

### *Concentration of Credit Risk*

The Special Service District currently does not place a limit on the amount it may invest with any one issuer. More than 5 percent of the Special Service District's investments are in the following investments as of December 31, 2005:

	<u>Percentage</u>
Zions First National Bank	19%
Washington Mutual	17%

### *Investment Income*

Investment income and gains and losses on assets limited as to use, cash equivalents, and other investments consists of the following for the years ended December 31, 2005 and 2004:

#### Nonoperating revenues (expenses)

Interest income	<u>\$ 25,251</u>	<u>\$ 12,463</u>
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## NOTES TO FINANCIAL STATEMENTS

### NOTE 8 - CAPITAL ASSETS

Capital assets additions, retirements, and balances for the years ended December 31, 2005 and 2004 are as follows:

	Balance December 31, 2004	Additions	Retirements	Balance December 31, 2005
Land	\$ 141,814	\$ -	\$ -	\$ 141,814
Buildings	5,260,016	-	-	5,260,016
Fixed equipment	11,052	-	-	11,052
Movable equipment	3,816,816	140,714	-	3,957,530
Totals at historical cost	9,229,698	140,714	-	9,370,412
Less accumulated depreciation for:				
Buildings	1,565,799	214,850	-	1,780,649
Fixed equipment	8,466	1,719	-	10,185
Movable equipment	2,477,113	353,286	-	2,830,399
Total accumulated depreciation	4,051,378	569,855	-	4,621,233
Capital assets, net	\$ 5,178,320	\$ (429,141)	\$ -	\$ 4,749,179
	Balance December 31, 2003	Additions	Retirements	Balance December 31, 2004
Land	\$ 141,814	\$ -	\$ -	\$ 141,814
Buildings	5,260,016	-	-	5,260,016
Fixed equipment	11,052	-	-	11,052
Movable equipment	3,607,533	209,283	-	3,816,816
Totals at historical cost	9,020,415	209,283	-	9,229,698
Less accumulated depreciation for:				
Buildings	1,350,221	215,578	-	1,565,799
Fixed equipment	8,108	358	-	8,466
Movable equipment	2,124,747	352,366	-	2,477,113
Total accumulated depreciation	3,483,076	568,302	-	4,051,378
Capital assets, net	\$ 5,537,339	\$ (359,019)	\$ -	\$ 5,178,320

(continued on next page)

## NOTES TO FINANCIAL STATEMENTS

### NOTE 9 - LONG-TERM DEBT

Long-term debt consists of the following at December 31, 2005 and 2004:

	December 31, 2004	Additions	Reductions	December 31, 2005	Due Within One Year
Hospital Sales Tax Revenue and Refunding Bonds	\$ 1,725,407	\$ -	\$ 406,153	\$ 1,319,254	\$ 422,078
Total long-term debt	<u>\$ 1,725,407</u>	<u>\$ -</u>	<u>\$ 406,153</u>	<u>\$ 1,319,254</u>	<u>\$ 422,078</u>
	Balance December 31, 2003	Additions	Reductions	Balance December 31, 2004	Amounts Due Within One Year
Hospital Sales Tax Revenue and Refunding Bonds	\$ 2,116,015	\$ -	\$ 390,608	\$ 1,725,407	\$ 406,153
Total long-term debt	<u>\$ 2,116,015</u>	<u>\$ -</u>	<u>\$ 390,608</u>	<u>\$ 1,725,407</u>	<u>\$ 406,153</u>

#### *Long-Term Debt*

The terms and due dates of the Special Service District's long-term debt at December 31, 2005 and 2004 are as follows:

- On February 3, 2003, the Special Service District issued \$2,500,000 in Hospital Sales Tax Revenue and Refunding Bonds - Series 2003 (Series 2003 Bonds) for the purpose of refinancing \$891,985 in General Obligation Hospital Bonds - Series 1996, to finance the acquisition of property and equipment, and to pay for the costs of issuance. The Series 2003 Bonds bear an interest rate of 3.83 percent and will be repaid in level debt payments to January 1, 2009.

The Special Service District refunded the General Obligation Hospital Bonds - Series 1996 to reduce its total debt service payments for the 2005 fiscal year, although total cash payments through January 1, 2009 will be more, and to obtain an economic gain of approximately \$75,000.

## NOTES TO FINANCIAL STATEMENTS

Scheduled principal and interest repayments on long-term debt are as follows:

<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 422,078	\$ 48,922	\$ 471,000
2007	438,627	32,373	471,000
2008	458,549	15,224	473,773
Total	<u>\$ 1,319,254</u>	<u>\$ 96,519</u>	<u>\$ 1,415,773</u>

### NOTE 10 - RETIREMENT PLAN

The Special Service District has a defined contribution retirement plan for essentially all employees. The Special Service District gives a one percent contribution to all employees and a voluntary matching contribution up to 3 percent of employee contributions. Total retirement plan expense for the years ended December 31, 2005 and 2004 was \$81,755 and \$77,010.

### NOTE 11 - CONTINGENCIES

#### *Malpractice Insurance - Health Care Industry*

The Special Service District has malpractice insurance coverage to provide protection for professional liability losses on a claims-made basis subject to a limit of \$1 million per claim and an annual aggregate limit of \$3 million. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, will be uninsured.

The health care industry is subject to laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Recently, federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties as well as significant repayments of previously billed and collected revenues for patient services. Management believes the Special Service District is in substantial compliance with current laws and regulations.



## NOTES TO FINANCIAL STATEMENTS

### NOTE 12 - CONCENTRATION OF CREDIT RISK

The Special Service District grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from third-party payors and patients at December 31, 2005 and 2004 was as follows:

	<u>2005</u>	<u>2004</u>
Medicare	21%	34%
Utah Medicaid	10%	10%
Arizona Medicaid	4%	5%
Blue Cross	5%	7%
Other third-party payors	41%	32%
Patients pay	19%	12%
Total	<u>100%</u>	<u>100%</u>



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**INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION**

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The Board of Trustees  
Kane County Human Resource  
Special Service District  
dba Kane County Hospital  
Kanab, Utah

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*EideBailly LLP*

Minneapolis, Minnesota  
March 30, 2006

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**KANE COUNTY HUMAN RESOURCE  
SPECIAL SERVICE DISTRICT  
DBA KANE COUNTY HOSPITAL  
KANE COUNTY HOSPITAL AUXILIARY FUND  
YEARS ENDED DECEMBER 31, 2005 AND 2004**

Included in these financial statements is the Kane County Hospital Auxiliary Fund (Auxiliary), whose purpose is to provide financial support to the Special Service District. As of December 31, 2005 and 2004, the balance sheets of the Auxiliary are detailed below:

**BALANCE SHEETS**  
December 31,

	2005	2004
<b>ASSETS</b>		
Cash and cash equivalents	\$ 50	\$ 50
Cash and cash equivalents - Securities held at Utah Public Treasurer's Investment Fund	4,160	39,933
Assets limited as to use	51,746	76,693
Thrift Shop - building	174,376	109,006
Thrift Shop - parking lot	37,870	37,870
Thrift Shop - floor covering	3,418	3,418
Accumulated depreciation	(70,252)	(63,704)
Total assets	<u>\$ 201,368</u>	<u>\$ 203,266</u>
<b>UNRESTRICTED NET ASSETS</b>	<u>\$ 201,368</u>	<u>\$ 203,266</u>

The change in assets limited as to use of the Auxiliary for the fiscal years ended December 31, 2005 and 2004, are detailed in the following statements of changes in assets limited as to use:

**STATEMENTS OF CHANGES IN ASSETS LIMITED AS TO USE**  
Years Ended December 31,

	2005	2004
<b>ASSETS LIMITED AS TO USE, BEGINNING OF YEAR</b>	<u>\$ 76,693</u>	<u>\$ 31,172</u>
<b>RECEIPTS</b>		
Sales	78,181	91,539
Interest income	512	275
Total receipts	<u>78,693</u>	<u>91,814</u>
<b>DISBURSEMENTS</b>		
Donations to Kane County Hospital	(40,074)	(6,252)
Salaries	(22,441)	(18,964)
Supplies	(7,768)	(5,202)
Utilities	(3,914)	(8,875)
Other	(2,127)	1,462
Amounts transferred to the Building Fund	(19,500)	-
Amounts transferred to the Utah Public Treasurer's Investment Fund	(7,816)	(8,462)
Total disbursements	<u>(103,640)</u>	<u>(46,293)</u>
<b>ASSETS LIMITED AS TO USE, END OF YEAR</b>	<u>\$ 51,746</u>	<u>\$ 76,693</u>



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## INDEPENDENT AUDITOR'S REPORT ON STATE OF UTAH LEGAL COMPLIANCE

The Board of Trustees  
**Kane County Human Resource  
Special Service District**  
**dba Kane County Hospital**  
Kanab, Utah

We have audited the accompanying financial statements of **Kane County Human Resource Special Service District, dba Kane County Hospital (Special Service District)**, for the year ended December 31, 2005, and have issued our report thereon dated March 30, 2006. As part of our audit, we have audited the Special Service District's compliance with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; special tests and provisions applicable to each of its major State assistance programs as required by the *State of Utah Legal Compliance Audit Guide* for the year ended December 31, 2005. The Special Service District received the following major State assistance program from the State of Utah:

Mineral Lease Funds (Department of Transportation)    \$139,215

Our audit also included testwork on the Special Service District's compliance with the following general compliance requirements identified in the *State of Utah Legal Compliance Audit Guide*, including:

- Public Debt
- Cash Management
- Purchasing Requirements
- Budgetary Compliance
- Special Districts
- Other General Issues

The management of the Special Service District is responsible for the Special Service District's compliance with all compliance requirements identified above. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the Special Service District's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

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The results of our audit procedures disclosed no instances of noncompliance with requirements referred to above.

In our opinion, the **Kane County Human Resource Special Service District, dba Kane County Hospital**, complied, in all material respects, with the general compliance requirements identified above and the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; and special tests and provisions that are applicable to each of its major State assistance programs for the year ended December 31, 2005.

This information is intended solely for the use of the Board of Trustees and management of the Special Service District, Kane County Commissioners, and the State of Utah and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Eide Bailly LLP". The signature is written in a cursive, flowing style.

Minneapolis, Minnesota  
March 30, 2006



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**INDEPENDENT AUDITOR'S REPORT ON INTERNAL  
CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS AND COMMUNICATIONS WITH AUDIT COMMITTEE**

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The Board of Trustees  
Kane County Human Resource  
Special Service District  
dba Kane County Hospital  
Kanab, Utah

We have audited the accompanying financial statements of Kane County Human Resource Special Service District, dba Kane County Hospital (Special Service District) as of and for the year ended December 31, 2005, and have issued our report thereon dated March 30, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Special Service District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Special Service District's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the following sections titled "Current Year Findings," and "Prior Year Findings."

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described below is a material weakness.

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## Current Year Findings

### Exceeding Limit on Personal Time Off

During the audit it was noted that nine employees were over accrued on their personal time off. We recommend the Special Service District follows its policy and encourage employees to take vacations or to amend the policy.

*Management Response* – Management of the Special Service District will monitor the personal time off for each employee and will follow the written policy of the Special Service District.

### Limited Size of Office Staff

Due to the limited number of staff in the business office and accounting departments, certain functions within the departments are not segregated which normally would enhance internal control. However, certain administrative controls are in place, which mitigate the risk of incompatible duties due to employing a limited number to staff.

We recommend the Special Service District continue to review duties and assignments within its operation to ensure appropriate segregation of duties, where possible and strengthen internal control.

*Management Response* – Management at the Special Service District continues to review the duties and assignments within its operation to ensure appropriate segregation of duties. However, due to the limited number of staff in the business and accounting departments, certain functions cannot be further segregated with would enhance internal control.

## Prior Year Findings

### Reconciling Balance Sheet Accounts

Numerous balance sheet accounts were not reconciled to their sub-ledgers when we arrived for audit fieldwork the week for April 4, 2005, and in discussions with the Special Service District's administration, the financial staff at the Special Service District failed to reconcile major and material general ledger balances to underlying detail during the 2004 fiscal year. The balance sheet accounts that were not reconciled to the supporting details as of April 4, 2005 are noted below:

- General Checking
- Payroll Checking
- Accounts Receivable – refund clearing
- Accounts Receivable – other clearing account
- All contractual allowance accounts
- Other receivables
- Inventory
- Capital Assets and accumulated depreciation
- Accounts Payable
- Accounts Payable – Manual Accrual
- All Accrued Expense accounts

It should be noted we made similar comments regarding balance sheet accounts that were not reconciled to their supporting sub-ledgers for the 2003 year end audit. Balance sheet accounts should be reconciled to supporting detail on a monthly basis. This is a tenant of a good internal control system and helps assure that errors, defaultations, and fraud, if present, will be identified. We recommend management implement procedures to reconcile balance sheet accounts on a monthly basis, and the Board of Trustees should follow up with management on a periodic basis to verify that all balance sheet accounts are reconciled to supporting detail.

*Management Response* – Management at the Special Service District implemented our recommendations during the 2005 fiscal year and the balance sheet accounts were reconciled to their sub-ledgers when we arrived for the 2005 audit fieldwork the week of March 27, 2006, and in discussions with the Special Service District's administration, the financial staff at the Special Service District did reconcile the major and material general ledger balances to underlying detail on a timely basis during the last six months of fiscal 2005.

#### Limited Size of Office Staff

Due to the limited number of staff in the business office and accounting departments, certain functions within the departments are not segregated which normally would enhance internal control. However, certain administrative controls are in place, which mitigate the risk of incompatible duties due to employing a limited number of staff.

We recommended the Special Service District continue to review duties and assignments within its operation to ensure appropriate segregation of duties, where possible and strengthen internal control.

*Management Response* – Management at the Special Service District continued to review the duties and assignments within its operation to ensure appropriate segregation of duties. However, due to the limited number of staff in the business and accounting departments, certain functions cannot be further segregated which would enhance internal control.

#### Approval of Manual Journal Entries

We noted manual journal entries were not always being reviewed and approved. All manual journal entries should be reviewed and approved. We recommended a policy for review of all journal entries be implemented at a level above the preparer.

*Management Response* – Management at the Special Service District considered this recommendation, but decided not to implement this suggestion.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Special Service District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

\*\*\*\*\*



### **Communications with the Board of Trustees**

Professional standards require that we provide you with the following information related to our audit.

#### **Our Responsibility Under Auditing Standards Generally Accepted in the United States of America and Government Auditing Standards**

As stated in our engagement letter dated March 1, 2006, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Special Service District. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Special Service District's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

#### **Other Information in Documents Containing Audited Financial Statements**

It is our understanding the Special Service District's financial statements as of and the year ended December 31, 2005 will be included in Kane County's audited financial statements.

#### **Significant Accounting Policies**

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Special Service District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year 2005. We noted no transactions entered into by the Special Service District during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

#### **Accounting Estimates**

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were estimated net realizable value of patient accounts receivable and notes receivable, and amounts due from/to third-party payors for cost report settlements.

Management's estimate of the collectibility of patient and notes receivables are based on historical trends for uncollectible accounts and contractual adjustments. The estimate of the amounts either owed to or receivable from third-party payors is based on both final and tentatively settled cost reports. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. There is a reasonable possibility that recorded estimates will change by a material amount in the near term. Management believes the estimates for all open years are adequate. Any differences between the estimates and the final settlements will be recorded in the period the final settlements are made and will not be treated as prior period adjustments.

We evaluated the key factors and assumptions used to develop the estimates related to the collectibility of patient receivables and notes receivables and the amounts either owed to or receivable from third-party payors in determining that the estimates are reasonable in relation to the financial statements taken as a whole.

#### **Audit Adjustments**

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Special Service District's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Special Service District, either individually or in the aggregate, indicate matters that could have a significant effect on the Special Service District's financial reporting process.

The significant audit adjustments resulting from our audit of the Special Service District's 2005 financial statements were as follows:

- To adjust sales tax receivable to actual balance - \$50,596
- To record the net assets of the Foundation - \$21,844
- To adjust the estimated settlements from third party settlements \$192,683

The net effect of our adjustments was to increase net assets by \$265,123.

#### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

#### **Consultations with Other Independent Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Special Service District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

### Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Special Service District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

### Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

\*\*\*\*\*

### Other Matters

#### Days in Patient Accounts Receivable and Notes Receivables

In prior year letters, we recommended the Special Service District implement additional follow-up procedures to promptly bill and collect patient accounts receivable and notes receivable in order to reduce the dollar amount and the number of days revenue outstanding in patient accounts receivable to approximately 65 days.

The following schedule highlights the Special Service District's number of days revenue outstanding in patient accounts receivable and notes receivable and patient accounts receivable as of the last five balance sheet dates:

<u>December 31,</u>	<u>Number of Days Revenue Outstanding - Patient Accounts Receivable and Notes Receivable</u>	<u>Number of Days Revenue Outstanding - Patient Accounts Receivable Only</u>
2005	115	97
2004	137	114
2003	97	77
2002	89	58
2001	85	57

The number of days revenue outstanding in patient accounts receivable and notes receivable as of December 31, 2005 decreased from the December 31, 2004, and increased from 2003 levels. The decrease in the number of days revenue outstanding from 114 days as of December 31, 2004, to 97 days as of December 31, 2005, increased the Special Service District's cash flow by approximately \$300,000. We encourage management to continue to strive to reduce the number of days revenue outstanding to industry standards of approximately 65 days.

### Disaster Recovery Plan

We recommend that the Special Service District establish a disaster recovery plan. A disaster recovery plan can identify and help the organization manage risks relevant to the preparation of financial statements.

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Conclusion

This information is intended solely for the use of the Board of Trustees and management of the Special Service District, Kane County Commissioners, and the State of Utah and is not intended to be and should not be used by anyone other than these specified parties.

Eide Bailey LLP

Minneapolis, Minnesota  
March 30, 2006